

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 IO-13 ISO-00 AID-05 CIAE-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-05
CEA-01 L-03 H-01 PA-01 PRS-01 DOE-11 SOE-02 /123 W
-----077266 051953Z /45

R 051805Z JAN 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 1755
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMCONSUL BELFAST
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USMISSION GENEVA
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USEEC ALSO FOR EMBASSY
USOECN ALSO FOR EMBASSY
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DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: EFIN, UK, EGEN, PINT
SUBJECT: CHANCELLOR HEALEY LOOKS TO 1978

SUMMARY: THE CHANCELLOR'S ANNUAL NEW YEAR'S MESSAGE
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PAINTS A ROSY PICTURE OF BRITAIN'S ECONOMIC FUTURE, ONE
BASED ON FISCAL AND MONETARY RECTITUDE AND A COMMITMENT
TO REBUILDING BRITISH INDUSTRY. THE MESSAGE SEEMS AIMED
AT OCCUPYING THE MIDDLE GROUND OF ECONOMIC POLICYMAKING
AND CONTAINS LITTLE OF APPEAL TO EITHER EXTREME OF THE
POLITICAL OR ECONOMIC SPECTRUM. END SUMMARY

1. IN HIS ANNUAL NEW YEAR MESSAGE, THE CHANCELLOR OF THE EXCHEQUER STRIKES AN OPTIMISTIC NOTE ABOUT THE YEAR TO COME. HE EXPECTS

- A SUBSTANTIAL CURRENT ACCOUNT SURPLUS
- SINGLE DIGIT INFLATION
- INCREASED REAL GROWTH AND INCOMES
- A STEADY DECLINE IN UNEMPLOYMENT

NOTING THAT NORTH SEA OIL BENEFITS WILL BE SUBSTANTIAL IN 1978, MR. HEALEY SPEAKS OF THE NEED TO USE THEM TO STRENGTHEN BRITAIN'S MANUFACTURING BASE AND DEVELOP ALTERNATIVE ENERGY SOURCES.

2. THE CHANCELLOR REAFFIRMS THE GOVERNMENT'S INTENTION TO "KEEP THE GROWTH IN THE MONETARY AGGREGATES UNDER FIRM CONTROL" SO AS TO MAINTAIN THE FINANCIAL STABILITY FUNDAMENTAL TO IMPROVED PROSPECTS IN THE REAL ECONOMY. PUBLIC EXPENDITURE, ACCORDING TO THE CHANCELLOR, WILL ALSO REMAIN UNDER FIRM CONTROL ALTHOUGH HE HASTENS TO ADD THAT THIS DOES NOT RULE OUT ALL GROWTH IN SPENDING. RATHER, GROWTH IN PUBLIC SPENDING IS INTENDED TO BE SLOWER THAN THAT IN OVERALL GDP. THE CHANCELLOR EXPLAINS THAT SLOWER INCREASES IN GOVERNMENT SPENDING ALLOW FOR THE NEED TO REDUCE PERSONAL TAXATION AND TO REDUCE HIGH MARGINAL TAX RATES AT ALL INCOME LEVELS.

3. INCOME TAX CUTS ARE PRESENTED AS A NON-INFLATION-LIMITED OFFICIAL USE

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ARY ALTERNATIVE TO WAGE INCREASES. MR. HEALEY AGAIN STRESSES THE NEED TO HOLD AVERAGE EARNINGS TO 10 PERCENT AS ESSENTIAL TO SUSTAINED SINGLE DIGIT INFLATION AS WELL AS TO MAINTAINING UK EXPORT COMPETITIVENESS IN THE FACE OF AN APPRECIATING CURRENCY.

4. IN THE CHANCELLOR'S VIEW, THE KEY TO ACHIEVING ALL THESE OBJECTIVES IS A SUSTAINED IMPROVEMENT IN BRITAIN'S INDUSTRIAL PERFORMANCE. THIS IS THE GOAL OF THE GOVERNMENT'S INDUSTRIAL STRATEGY WHICH ACCORDING TO MR. HEALEY HAS REACHED THE CRITICAL POINT OF MOVING DOWN FROM THE SECTOR LEVEL TO THAT OF THE INDIVIDUAL FIRM BRINGING WORKERS AND MANAGERS TOGETHER TO "TAKE THE ACTION NECESSARY TO IMPROVE OUR INDUSTRIAL PERFORMANCE."

5. COMMENT: THE CHANCELLOR'S MESSAGE IS NOTABLE FOR SEVERAL REASONS. FIRST, THE CLEAR STATEMENT THAT THE GOVERNMENT INTENDS TO HOLD THE RATE OF GROWTH IN PUBLIC EXPENDITURE BELOW THAT OF GDP IN THE COMING YEAR INDICATES THAT THE IMMINENT PUBLIC EXPENDITURE WHITE PAPER FOR FY 78/79 WILL CONTAIN LITTLE IN THE WAY OF ADDITIONAL PUBLIC EXPENDITURE BEYOND THAT ANNOUNCED IN THE OCT-

OBER 26, 1977 MINI-BUDGET. THAT SAID, THE SPRING BUDGET IS LIKELY TO CONTAIN SUBSTANTIAL TAX CUTS (I.E., MORE THAN ENOUGH TO OFFSET FISCAL DRAG). THESE ARE BEING JUSTIFIED AS NECESSARY TO REMOVE "A DISINCENTIVE TO THE

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EXTRA EFFORT WE NEED TO IMPROVE OUR INDUSTRIAL PERFORMANCE" AS WELL AS STIMULATING AGGREGATE DEMAND.

6. SECOND, THERE IS THE PUBLIC RECOGNITION THAT HIGH MARGINAL INCOME TAX RATES ARE A DISINCENTIVE TO IMPROVED INDUSTRIAL PERFORMANCE. THIS IS AN IMPORTANT EVOLUTION IN GOVERNMENT POLICY WHICH HAS HERETOFORE STRESSED THE NEED TO CUT TAXES WITHOUT CHANGING MARGINAL TAX RATES. SHOULD THE SPRING BUDGET PRODUCE CUTS IN MARGINAL RATES

OF TAXATION, THERE IS LIKELY TO BE A STRONG, BUT PASSING,
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REACTION FROM LABOR'S LEFT-WING.

7. THE CHANCELLOR'S MESSAGE HOLDS OUT LITTLE CHEER TO
THOSE CLAMORING FOR SUBSTANTIAL INCREASES IN PUBLIC EX-
PENDITURE AS A MEANS OF CUTTING UNEMPLOYMENT NOR TO THOSE
CALLING FOR FURTHER SPENDING CUTS. IT APPEARS TO PLACE
GREATER WEIGHT ON THE NEED FOR FURTHER IMPROVEMENT IN
THE RATE OF PRICE INCREASE THAN IT DOES ON THE NEED TO
CUT UNEMPLOYMENT. IN SHORT, IT IS A KIND OF LET'S NOT
ROCK THE BOAT MESSAGE, ONE THAT REFLECTS THE INCREASING
CONFIDENCE OF A GOVERNMENT THAT BELIEVES IT HAS FINALLY
SUCCEEDED IN GETTING THE ECONOMY MOVING. MR. HEALEY'S
OPTIMISM HAS PROVED UNFOUNDED IN THE PAST; HIS CURRENT
FOUNDATIONS LOOK A BIT MORE SOLID. HE IS OPTING FOR FI-
NANCIAL CONSERVATISM AND LESS GOVERNMENT CONTROL OF AGGRE-
GATE DEMAND.

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